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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 001085

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SUBJECT: EEB A/S SULLIVAN DISCUSSES AZERBAIJAN'S ECONOMIC
SITUATION, EITI, CORRUPTION

REF: BAKU 000949

Classified By: AMB. ANNE DERSE for reasons 1.4 (b) and (d).

¶1. (C) Summary: During his August 15-16 visit to Baku, EEB A/S Sullivan discussed economic cooperation with the American Chamber of Commerce Board of Directors, President of the State Oil Fund Movsumov, Minister of Economic Development Babayev, Minister of Finance Sharifov (septel), and local international financial institutions and NGOs. While Movsumov and Babayev detailed steps the GOAJ is taking to counter growing inflation, they also expressed a view - seemingly widely shared within the GOAJ - that the economy can handle the current 15-20 percent inflation and that this is a period Azerbaijan must just "get through." Babayev reaffirmed GOAJ support for WTO accession and said the Ministry of Economic Development (MED) had prepared a presidential decree to accelerate the process; he also noted that certain sectors remained opposed to WTO accession. Local international financial institutions and NGOs gave a readout of the business operating environment in Azerbaijan and corruption. The American Chamber of Commerce highlighted sectors in the Azerbaijani economy where the GOAJ has said it hopes to attract involvement by U.S. companies. End Summary.

¶2. (C) During his August 15-16 visit to Baku, A/S Sullivan met with Minister of Economic Development Babayev, President of the State Oil Fund Movsumov, Minister of Finance Sharifov (septel), the American Chamber of Commerce Board of Directors, and local representatives of international financial institutions and NGOs. Other USG officials at the meetings included Ambassador Derse, EEB's Rob Garverick, USDA's General Counsel James Wilderotter, DOE's analyst Tyler Tiller, and Pol/Econ officers (notetaker). A/S Sullivan's energy discussions are reported septel.

Breakfast with the American Chamber of Commerce

¶3. (SBU) During a breakfast with the American Chamber of Commerce Board of Directors (AmCham Board), A/S Sullivan discussed with the Board the potential for increasing U.S. companies' representation in the Azerbaijani market. The AmCham Board said that the GOAJ had made clear to them in recent meetings that it would welcome U.S. participation in major new development initiatives and projects in the following sectors: Electricity, Municipal Housing, Water/Sanitation, and Franchising. The AmCham Board said that it seeks USG support in finding and attracting quality U.S. companies to participate in a major trade mission to Azerbaijan that it would like to sponsor to take advantage of these opportunities.

14. (SBU) A/S Sullivan offered to connect AmCham with various U.S. Chamber of Commerce and Department of Commerce representatives that could serve as a conduit for bringing AmCham together with interested U.S. companies. A/S Sullivan and AmCham also discussed the idea of a "Business Entrepreneurial Council" to engage in regular dialogue with President Aliyev about the business climate, comprised of representatives of leading business associations with AmCham leading the effort and serving in the Secretariat of the Council. A/S Sullivan noted that he had encouraged President Aliyev to consider the idea he and the AmCham Board agreed that it was important to follow-up with the Presidential Apparatus and President Aliyev to discuss the Council. (NOTE: In an August 23 meeting with the AmCham Board of Directors, Presidential Economic Advisor Vahid Akhundov agreed that there was a need to establish regular communications between the GOAJ and the business community. Akhundov said that he would brief President Aliyev on AmCham's vision of a revitalized Business Entrepreneurial Council, and would recommend that President Aliyev meet the AmCham "in the near future" to further discuss the issue).

SOFAZ President Movsumov

15. (C) State Oil Fund (SOFAZ) President Movsumov gave a brief history of the Fund and said that the Fund currently holds roughly \$2 billion, an amount he expects to grow by another \$5 billion in 2008 and by another \$9 billion in 2009. Movsumov complimented the role that USTDA played in setting up the Fund and commented that the Fund's institutional capacity is inching forward. Movsumov said that the Fund is carrying out its mission to manage wealth constructively and

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channel the funds into projects in the "social and development" areas that will have long-term dividends for the GOAJ. In response to a Sullivan query about the kinds of projects that the Fund participates in, Movsumov said that the Fund helped finance the BTC pipeline, will help finance the Baku-Tbilisi-Kars railroad, will finance a local irrigation project, the start-up of an Azerbaijani investment company in which SOFAZ plays a role on the supervisory board, will support the transition of the pension system from partially-funded to fully-funded, and the GOAJ's new program to send students abroad to study.

16. (C) A/S Sullivan also discussed the Extractive Industries Transparency Initiative (EITI) pointing out the "free rider" problem and stating that many countries belong to the EITI and receive the praise for doing so, but have yet to truly implement EITI-mandated provisions for transparency. Movsumov said that he and the EITI have similar concerns, adding that he raised this issue with the Board of Directors and other members of the EITI, and that the Board was planning to vote on this issue at the next Board meeting in Oslo. Movsumov said that the GOAJ is currently trying to move the UN forward on a resolution endorsing EITI and is encouraging Norway to consider becoming an EITI member and implement EITI provisions to counter a spreading mindset among less-developed countries that the EITI is something imposed on them by richer countries. Movsumov hopes that, one day, EITI will lead to worldwide implementation of its provisions and, perhaps, the U.S. may join.

17. (C) Movsumov also commented that the Fund is working to alleviate Azerbaijan's inflation problem. Movsumov said that is an on-going debate within the GOAJ about whether to spend more of the oil money now on much needed roads and construction, which fuels inflation, or to save more and invest in long-term projects. Movsumov said that, right now, inflation in the economy is manageable because real disposable income is rising to compensate for the rise in prices. Nevertheless, Movsumov said that the GOAJ is working with experts to find ways to counter the problem, including

working with the BP-provided economic model that shows the tradeoffs of funding different, non-oil sector projects and their effect on the economy.

MED Babayev

18. (C) During his August 15 meeting with Minister of Economic Development (MED) Heydar Babayev, A/S Sullivan outlined his visit to Turkmenistan and told Babayev that he had mentioned to Turkmen officials that Azerbaijan was a better economic model for Turkmenistan's new leadership than the former Soviet Union. Babayev said the GOAJ is receiving a positive message from the Turkmen leadership and has a bright future as a transit country. The Kazakhs have now seen that Russia is an unreliable partner and are supporting a Trans-Caspian pipeline, he said. Babayev added that Kazakhstan and the GOAJ have created a foundation to finance important regional projects. Noting that the GOAJ has signed an energy MOU with Greece, Babayev said that transit negotiations are underway with Turkey and the GOAJ expects to reach a new agreement once the new Turkish government is formed. Babayev told Sullivan that Azerbaijan provides 70 percent of Georgia's gas demand and there will be a similar statistic for Turkey soon. Separately, he said the GOAJ would discuss a pipeline project with the Israeli Deputy Prime Minister during his visit to Azerbaijan. If Jordan remains positive about it, Babayev said there was a potential for regional cooperation.

19. (C) Babayev told Sullivan the GOAJ's WTO accession efforts are ongoing, but that he is unhappy with the slow pace. He said that four of the required legislative changes have been implemented, and that in June 2007 during the last meeting of Azerbaijan's WTO Commission, it was unanimously decided to ask the President to enlarge and expand the role and responsibilities of the Commission. The MED also has presented a nine-step WTO accession roadmap to the President for approval, Babayev said (reftel). Some bilateral agreements have been reached with Georgia, Moldova, Oman and the UAE, while others are ongoing. Babayev pointed out that some recent developments, e.g. in Kyrgyzstan, had negatively impacted the image of the WTO, but that the GOAJ is past questioning whether to join and is fully committed to accession. The GOAJ is definitely examining the benefits and costs of accession with a view to addressing the costs.

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Babayev told Sullivan that the business climate in Azerbaijan still requires significant improvement. He said the GOAJ has engaged with the authors of the World Bank's Doing Business Report to agree on what improvements, like on licensing and registration, should be implemented to improve Azerbaijan's score. Babayev said the GOAJ sees the necessity of the changes, as an important method of improving its ability to attract additional investment. Sullivan noted that there would have to be efforts also to educate the public about the WTO and an open economy.

10. (C) Babayev said that the lack of progress toward economic liberalization has contributed to Azerbaijan's double-digit inflation. He noted that inflation is higher in the food market than in the overall economy and attributed that to high quality Azerbaijani products commanding higher prices domestically and in Russia. Azerbaijan's current inflation is still acceptable, Babayev asserted, while acknowledging that his deputies did not agree. Babayev said the GOAJ cannot be afraid of inflation as it spends money on essential social infrastructure development. He asserted that despite inflation, the population has experienced a 17-20 percent increase in real income in 2006. Using previous U.S. experiences as an example, Sullivan told Babayev that once double-digit inflation is built in, it becomes harder to eliminate. He pointed to the anti-inflationary influence that joining the WTO could have by increasing competition and reducing the price of imports.

¶11. (C) American companies bring benefits like increased training and technology, Sullivan said, and the Ambassador is looking for ways to increase their participation. The Ambassador told Babayev she had been invited to speak at the influential Business Roundtable and that this would be a great opportunity to promote greater awareness of actions that the GOAJ had taken to improve the business climate, assuming that the GOAJ is able to move forward on critical reforms in the near term. Babayev noted that the ongoing court case involving Americans that had purchased privatization vouchers, he hoped would be resolved soon. Babayev said the Azerbaijan Investment Company (AIC) was a good creation that protected foreign investors in the non-oil sector from corruption by making them partners with the GOAJ. Babayev pointed out that President Aliyev had decided that local investors could work with the AIC as well, and that in its second year AIC-domestic partnerships eclipsed the overall value of foreign investors.

Local IFIs & Economic NGOs

¶12. (C) In a lunch meeting hosted by the Ambassador, several representatives from the international financial institutions and economic non-government organizations briefed Sullivan on the current business operating environment. The international financial institutions and NGOs in attendance were the World Bank's Resident Representative Gregory Jedrzejczak, Head of the Azerbaijan Resident Mission of the Asian Development Bank Faraj Huseynbayov, Director of the Public Finance Monitoring Center Inqilab Akhmadov, Director of the Center for Economic Research Qubad Ibadoglu, Chairman of the network of NGO's for the Fight Against Corruption Alimammad Nuriyev, the World Trade Organization's Rashad Aliyev, Head of the EITI Coalition Sabit Bagirov. The meeting featured a broad-ranging discussion of corruption issues and the most effective regulatory and institutional strategies for promoting anti-corruption reform in Azerbaijan.

¶13. (C) In response to a question from Sullivan on corruption, Akhmadov said that one must distinguish between social corruption and government corruption. Akhmadov said that social corruption is much harder to control than government corruption because laws and administrative guidelines cannot effectively regulate traditional social norms/practices. Government corruption, however, is more easily identifiable because there are laws that set specific rules against corrupt government practices. Akhmadov said that EITI offers the possibility to tackle both forms because it can focus on state-owned companies for its anti-corruption efforts which, he emphasized, can have a trickle down impact on the workers and change social corruption incentives/practices. Nuriyev said that the opportunity to eliminate corruption lies in effective implementation of the legislation which sets the rules and the administrative/judicial enforcement stratagem. As an

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example, Nuriyev said that the hiring process for government positions must change because it is based on nepotistic practices. Where someone is from, or someone's family ties to the regime often determines whether the person gets the job.

¶14. (C) Sullivan asked the group if they thought it possible for the GOAJ to pass legislation making it illegal for government workers to own stocks in an important sector, such as the oil sector. Jedrzejczak replied that there already is legislation that prohibits ministers from being involved in businesses, but it has not been implemented. Bagirov said that any efforts to correct government structures or remove corruption from government structures will need to be accelerated in order to impact on the utilization of the oil revenues flowing into the GOAJ budgets.

